

Financial Management of the City

Managing the City's finances involves both a strategic and operational component. Strategically, the finances must be managed to accommodate fluctuations in the economy and resultant changes in revenues. Operationally, the City must put in place clear financial goals, policies, and tools to implement the strategic direction.

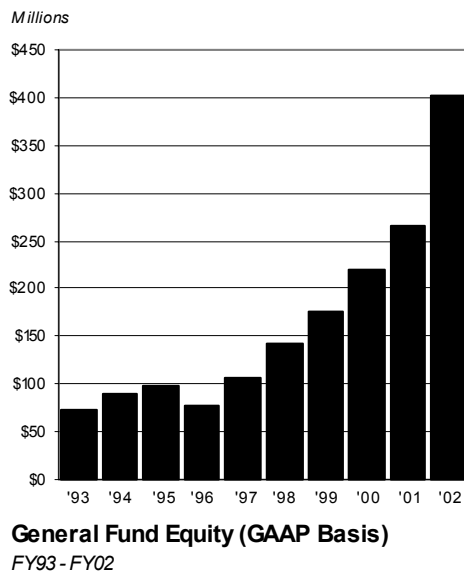


Figure 1

Over the previous fifteen years, the City's management of its finances has resulted in an upward trend in general fund equity. This trend was interrupted by only two events: the dramatic state aid reductions in FY91 and FY92; and, the merger of the city's two public hospitals with a private hospital to form a new private entity in 1996. It is expected that the latter event improved the City's future financial outlook by shielding the City from the likely growth in hospital subsidies that would have been required without the merger. (Figure 1.)

The City's general fund is the only fund for which a budget is legally adopted. Most of the City's general fund budget is raised and appropriated from the tax levy, which means it is supported by the revenues that are estimated to come in during the course of the fiscal year. A detailed discussion of these general fund revenues can be found in the Summary Budget chapter.

General Fund Equity

The City implemented Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, among others for FY02. GASB No. 34 redefined 'enterprise funds' resulting in two new enterprise funds, the Convention Center Fund and the Hospital Bond Fund. Both funds were established for activities related to bonds for which revenue streams have been pledged as security repayment. GASB No. 34 also fundamentally changed the treatment of liabilities and receivables in the General Fund. As a result of these changes, FY02 General Fund equity appears artificially high as compared to prior years displayed without these changes (Figure 1). For more information on the changes and their effects please refer to the City's Comprehensive Annual Financial Statements for Fiscal Year Ended June 30, 2002

It is expected that the actual results at close of FY03 and FY04, will not add to the upward trend in general fund equity that the City has experienced since FY97, due to the difficult budgets of these years as a result of national recession. The City hopes to preserve its policy of maintaining a GAAP Undesignated Fund Balance that is 10% or higher than GAAP General Fund Operating Expenditures throughout these years. The City's FY03 financial statements are expected to be available in November 2003.

<u>Parking Meter Fund</u>				
Fiscal Year	Beginning Year Balance	Funds Out	Funds In	Ending Year Balance
FY97	11.902	(8.500)	8.558	11.960
FY98	11.960	(8.500)	9.673	13.133
FY99	13.133	(1.500)	7.736	19.369
FY00	19.369	(5.031)	8.243	22.582
FY01	22.582	(6.677)	7.923	23.828
FY02	23.828	(2.790)	8.821	29.859
*FY03	29.859	(10.000)	7.700	27.559
*FY04	27.559	(10.000)	10.700	28.259

Notes: (\$millions), *projected

<u>Cemetery Trust Fund</u>				
Fiscal Year	Beginning Year Balance	Funds Out	Funds In**	Ending Year Balance
FY97	8.324	(0.700)	2.701	10.325
FY98	10.325	(0.700)	2.119	11.744
FY99	11.744	(1.589)	2.008	12.163
FY00	12.163	(1.724)	3.179	13.618
FY01	13.618	(2.943)	2.566	13.240
FY02	13.240	(1.778)	-0.678	10.784
*FY03	10.784	(1.849)	0.500	9.435
*FY04	9.435	(1.849)	1.000	8.586

Notes: (\$millions), *projected, **Includes appreciation

<u>Surplus Property Disposition Fund</u>				
Fiscal Year	Beginning Year Balance	Funds Out	Funds In	Ending Year Balance
FY97	33.862	0.000	0.047	33.909
FY98	33.909	0.000	0.000	33.909
FY99	33.909	0.000	0.000	33.909
FY00	33.909	0.000	0.191	34.100
FY01	34.100	0.000	8.474	42.574
FY02	42.574	0.000	13.300	55.874
*FY03	55.874	(14.876)	0.000	40.998
*FY04	40.998	(4.786)	0.000	36.212

Notes: (\$millions), *projected

Figure 2

GENERAL FUND
Statement of Revenues, Expenditures, and Changes in Fund Balances -
Governmental Funds
Years ended June 30 2002 and 2001
(in Thousands)

	\$	<u>2002</u>	\$	<u>2001</u>
Revenues:				
Real and personal property taxes		990,848		874,868
Excises		111,114		72,645
Payments in lieu of taxes		36,332		72,720
Fines		60,601		57,840
Investment income		14,596		26,289
Licenses and permits		33,325		36,795
Departmental and other		62,200		58,306
Intergovernmental		492,299		493,278
Total revenues		<u>1,801,315</u>		<u>1,692,741</u>
Expenditures:				
Current:				
General government		77,019		67,913
Human services		6,434		5,464
Public safety		405,844		373,362
Public works		74,651		77,241
Property and development		48,774		41,300
Parks and recreation		16,230		15,547
Library		28,695		30,360
Schools		627,653		611,368
Public health programs		64,537		-
County		4,537		6,030
Judgements and claims		2,724		5,011
Retirement costs		82,034		84,970
Other employee benefits		107,701		90,501
State and district assessments		67,769		66,788
Capital outlays		5,177		4,057
Debt Service		115,366		123,977
Total expenditures		<u>1,735,145</u>		<u>1,603,889</u>
Excess(deficiency) of revenues over expenditures		66,170		88,852
Other financing sources (uses):				
Operating transfers in		1,778		1,678
Operating transfers out				-
Transfers from component units				17,706
Transfers to component units				(62,476)
Total other financing sources		<u>1,778</u>		<u>(43,092)</u>
Net change in fund balance		67,948		45,760
Fund balance - beginning, restated(Note 3)		334,161		220,700
Fund balance - ending	\$	<u>402,109</u>	\$	<u>266,460</u>

Budgetary Fund Balance

Fund Balance can be appropriated for use during the fiscal year. Fund Balance, or Budgetary Fund Balance, is more commonly referred to as "Free Cash" when used this way. This item is most simply described as the portion of available reserves, generated to a considerable degree by annual operating surpluses, which the City can responsibly appropriate for spending. The law governing the calculation and availability of budgetary fund balance for cities and towns is Chapter 59, section 23 of Massachusetts General Law, and is administered by the Massachusetts Department of Revenue. The FY04 Budget assumes the use of a \$30.0 million appropriation from the fund balance of the general fund.

Available Funds

The City's general fund budget is also supported by some available funds. The three available funds that the City budgets each year are parking meter revenues to support the Transportation Department, cemetery trust monies to support the City's maintenance of its public cemeteries, and surplus property disposition proceeds to fund a risk retention reserve, which is discussed later in this chapter. Additional discussion about these revenue sources used to support the general fund operating budget can be found in the Summary

Budget section.

Figure 2 provides a history, as well as projected changes in fund balances, for the available funds used to support the City's general fund budget.

Auditing and Budgeting Practices

The City prepares its comprehensive financial reports in accordance with generally accepted accounting principles (GAAP). However, accounting practices established by the Commonwealth's Department of Revenue, the so-called budgetary basis method of accounting, are used in the annual budget and property tax certification process. Budgetary basis departs from GAAP in the following ways:

- (a) Real estate and personal property taxes are recorded as revenue when levied (budgetary), as opposed to when susceptible to accrual (GAAP).
- (b) Encumbrances and continuing appropriations are recorded as the equivalent of expenditures (budgetary), as opposed to a reservation of fund balance (GAAP).
- (c) Certain activities and transactions are presented as components of the general fund (budgetary), rather than as separate funds (GAAP).

Adjustments Between Budgetary Basis and GAAP Basis of Accounting for FY02

(in thousands)

	Revenue	Expenditures	Other Financing Sources (Uses), Net	Excess (Deficiency) of Revenue and Other Financing Sources
<u>As reported on a budgetary basis</u>	<u>1,788,300</u>	<u>1,783,133</u>		<u>5,167</u>
<u>Adjustments:</u>				
Revenues to modified accrual basis	66,740			66,740
Expenditures, encumbrances and accruals, net		3,959		(3,959)
<u>Reclassifications:</u>				
Parking meter revenue and expenditures to a special revenue fund	(2,790)	(2,790)		
Debt service expenditures	-	-		
State-funded teachers' retirement costs	(49,157)	(49,157)		
Trust fund revenue	(1,778)		1,778	
<u>As reported on a GAAP basis</u>	<u>1,801,315</u>	<u>1,735,145</u>	<u>1,778</u>	<u>67,948</u>

(d) Amounts raised for the prior years' deficits and available funds from prior years' surpluses are recorded as revenue items (budgetary), but have no effect on GAAP revenues.

In addition, there are certain differences in classifications between revenues, expenditures and transfers. The following reconciliation summarizes the differences between budgetary and GAAP basis accounting principles for the year ended June 30, 2001.

STRATEGIC FINANCIAL MANAGEMENT

Maintaining a healthy financial base that fully supports City services according to mayoral priorities requires constant vigilance. This work is reflected in balanced budgets, restructuring and reshaping City services, new financial management systems, efforts to secure sound recurring revenues, and responsible spending adjustments in light of revenue growth limitations. Inevitable fluctuations in the economic cycle mean that Boston must expect and be prepared to affirmatively tackle the financial challenges ahead.

Deciding to build the City's new convention center, for example, called upon the financial management skills of City officials. Sharing a significant portion of the cost of the project with the state will be accomplished without impairing the future delivery of city services. Also, by means of switching from market valuation of assets to actuarial valuation of assets, the City has managed its pension funding schedule during the market's last several years of volatility without its becoming a factor in reducing city services.

The City's revenue growth had been strong from FY94 through FY02. FY03 and FY04, and perhaps FY05, will be affected by the national recession of 2001-2002. Consequently, Boston budgeted conservative revenue growth in FY03 and revenue losses in FY04 – the first time since FY93 that the City's revenue will total less than the prior year. The City's budget will be reduced in spite of revenue enhancements, program cuts and consolidation of departmental services. Currently, FY05 projections again return to conservative growth in revenue.

Below are descriptions of some of the financial management tools the City has utilized to achieve positive results.

Strategic Economic Development

At the core of city government finances is a healthy Boston economy for all citizens. A critical area for economic development in Boston is the building of a new convention center. With the leadership of the Mayor, Governor, and legislative leaders, the Boston Convention and Exhibition Center is on schedule for substantial completion in Spring 2004. Using \$157.8 million in loan authorization by the City Council, the City completed site acquisition and groundbreaking occurred in spring of 2000. The loan is supported by hotel excise revenue from new hotels and from other new revenue sources. The Commonwealth is covering the cost of construction.

Additionally, as interest in commercial development in Boston continues, the Mayor has clearly stated that all decisions on when, where and what to build will be made with the interest of the City as a whole in mind.

Maximizing Return on Investment

Through various channels, the City's administration works to maximize the service delivery provided per dollar of revenue. In 1993, city government was reorganized into a cabinet structure that forces accountability. Today, work continues to constantly reassess the management organization and distribution of finances toward priority goals that maximize return on investment. The Office of Budget Management (OBM) continues to inform management of financial decisions through service-based budgeting and objective assessments of cost efficiencies and service delivery in certain areas.

Ongoing investment in the city's resources – people, property and systems—is key to guaranteeing solid service delivery for the future. Capital investments are made as part of the annual city budget, weighing changing service needs with the need for adequate building maintenance and upgrading. Human resource training has included specialized management training and a new performance appraisal system. The City's technology needs are continually assessed and updated on an ongoing basis. The City has recently implemented its first enterprise wide management information system.

Diversify the City's Revenue Stream

Eighty percent of total general fund revenue comes from just two sources, the property tax and

state aid from the Commonwealth. Both of these revenues are strictly controlled by state law and state legislative action. Therefore, the City remains alert to the possibility of diversifying its revenues. For example, in order to support the funding for the convention center, the City did not draw upon the current revenue base. Instead, new City revenue sources were established and earmarked for convention center funding. Among the city and state funding sources is an increase in the hotel excise tax in Boston and Cambridge, the full hotel excise tax for new hotels, the earmarking of certain state taxes in a convention center district, a car and truck rental fee, and the sale of additional taxi medallions. These revenue sources are targeted at those who will use the convention center or businesses that will profit from convention center activity, rather than burdening city residents. In spite of the increase, the hotel tax rate remains competitive with other major U.S. cities.

With substantial cuts in state aid already made in FY03 and even deeper cuts expected in FY04, along with waning excise and other revenue from the lagged effect of economic recession, the Mayor continues to express the City's desire to implement new revenue streams for the future growth of the City.

Specifically, the Mayor filed legislation to enact a 1% local option tax on prepared food and beverages sold in municipalities in addition to the 5% state tax already in place. If the Legislature were to adopt this local option revenue stream, the City could recover an estimated \$17 million annually. A meals tax is a good fit for what has become a strong tourist and travel economy in Boston. It would provide revenue growth at a nominal rate without a heavy burden on residents, tourists or travelers with the total rate of taxation remaining the lowest of any major City.

Additionally, the Mayor filed legislation to enact local option taxes on parking in commercial parking lots and on entertainment services such as concerts, sporting events and movies. The City, like other regional urban centers, expends considerable resources in traffic, police, fire and public works services in support of these businesses. But unlike other cities, Boston does not have any taxing authority to recover those

costs. Together, these local option taxes could generate over \$22 million annually.

Lastly, the City, with City Council approval for some, will raise several smaller fees that have been level for years, resulting in a nominal amount of revenue, raise parking fines for violations that lead to towing by the City transportation department, and raise some parking meter fees to generate another approximately \$10 to \$12 million.

As most of these revenue initiatives require approval from another political body, their passage is not assured. The City will be closely watching deliberations on these matters of critical importance and will continually stress the importance of a diversified and equitable revenue system.

Protect the City from Sudden, Unexpected Catastrophic Losses

Risk management efforts work to protect the City from sudden adverse asset losses, whether caused by a natural disaster, workplace injuries, a drop in revenues or sudden cost increases. Risk prevention efforts take place in all departments, for example: MIS maintains back-up tapes for computerized data; the Municipal Police implement a citywide security system; Risk Management provides departmental incident information; operating departments diversify vendors and implement long-term contracts. Although any asset loss has a financial impact, specific efforts to protect city finances include diversifying the City's revenue sources, maintaining a conservative debt ratio and a risk reserve, and prudent purchase of insurance. Risk prevention and financing efforts are further described later in this chapter.

Achieve a More Rational Separation of State and Municipal Obligations

Local policy judgments, rather than state mandates, must drive financial decisions. The City's greater-than-average share of county corrections costs, and the cost of state mandated charter schools are two clear examples of vulnerability to state mandates that do not necessarily reflect local priorities or ability to pay. The City has fought for and received a reduced share of county correction costs in the past but a

substantial inequity still remains. In FY99, the state recognized the cost impact of charter schools on hosting municipalities by partially reimbursing hosting communities for the cost of charter schools. But recently, the last two budgets proposed by the Governor (FY02 and FY03) have included a reduction in this reimbursement.

In recent years, the state itself has pursued a more rational separation of state and municipal obligations. The state recently withdrew from any obligation for future funding of cost-of-living adjustments for local government retirees. Meanwhile, it has continued to increase its support for local public education in which it bears responsibility for equalized and adequate public education.

These 5 items: strategic economic development, maximizing return on investment, a more diversified revenue base, protection against catastrophic costs, and rational separation of city and state obligations are prerequisites to the City's future financial health.

RESPONSIBLE OFFICIALS AND AGENCIES

The Mayor ultimately directs all of Boston's financial operations. The Mayor is the chief executive officer of the City and has general supervision of and control over the boards, commissions, officers, and departments of the City.

The City's Chief Operating Officer directs administrative services and labor relations.

City budget appropriations for all departments and operations of the City and Suffolk County, except the School Department and the county courts, are prepared by the Office of Budget Management, under the direction of the Chief Financial Officer.

The following six departments, which are included in the Chief Financial Officer's Cabinet, have major roles in the City's financial structure.

- The Treasury Department collects revenues due to the City and Suffolk County, and pays all amounts due for payrolls and to outside vendors. The Chief Financial Officer serves as the City's Collector-Treasurer. The Treasury Department also manages the investment of City funds, and supervises borrowings by the City in the form of either short-term or long-term debt.

- The Auditing Department maintains internal controls, manages grant funds, provides financial reports, maintains the financial records for the City and County, and approves all payments made by the City and County. The City Auditor is an ex-officio member of the State-Boston Retirement Board.
- The Assessing Department, managed by the Commissioner of Assessing, supervises the valuation, for tax levy purposes, of all real and personal property located in the City.
- The Office of Budget Management, in addition to overseeing the operating budget, also prepares and monitors the City's capital plan and coordinates the long-range capital planning activities of City and School departments.
- The Purchasing Department procures all supplies, materials, and equipment for City and County departments.
- The Retirement Board oversees the City's retirement system.

Three decision-making bodies also fill prominent roles in the City's budget process. The legislative body of the City is the City Council, which consists of 13 members serving two-year terms. Four are elected at-large and nine are elected from geographic districts. The City Council may enact ordinances and adopt orders, which the Mayor may either approve or veto. Only the Mayor can originate appropriation orders. Except for orders borrowing or appropriating money and for local adoption of a state statute involving the expenditure of money, the City Council may override a mayoral veto by a two-thirds vote. The City Council may reject or reduce a budget or budget item submitted to it by the Mayor, but may not increase it.

The City's public schools are under the control of the School Committee, which is appointed by the Mayor. The mayoral appointed governance structure was reaffirmed in a 1996 referendum by a 70% to 30% margin. The School Department operating budget is submitted to the Mayor and the City Council and is subject to their approval as part of a budget process parallel to, but separate from, the City and County.

Until FY91, the School Department regularly incurred operating deficits. Chapter 613 of 1987

placed stricter controls on the School Department's appropriation process, in an attempt to limit the potential for overspending, and strengthened the powers of the Superintendent vis-a-vis the School Committee. The Department, however, continued to deficit-spend. As a result, the City needed to ensure that other City spending remained below available revenues in order to offset the School Department deficits. These annual School Department deficits continued through FY90, ending only with the creation of an appointed School Committee accountable to the Mayor.

The Boston Public Health Commission is governed by a seven-member board with six of the members appointed by the Mayor, subject to City Council confirmation. It is responsible for the implementation of public health programs in the City and provides financial support for various health services. The Boston Public Health Commission must submit a revenue and expenditure budget to the Mayor. If and when the Mayor accepts the budget (essentially the deficiency between the revenues and expenditures), then it is submitted with the rest of the City and County budget to City Council.

INTERNAL MANAGEMENT CONTROLS

The City has established a system of internal management controls. These controls are designed to maximize revenue collections, manage operating and capital spending, evaluate infrastructure needs, and formalize the City's internal procedures. Major components of the City's system of financial management controls are discussed in the following paragraphs.

Capital Planning

The Office of Budget Management's Capital Budgeting Program (CBP) is responsible for managing the capital budget of the City. It has overseen the significant increase in the level of infrastructure investment, resulting in the protection and preservation of the City's capital assets and the creation of jobs in the construction sector. CBP's mission is to evaluate the condition of the City's capital stock, forecast the timing and financial requirements of new construction and rehabilitation, and recommend allocation of current and future resources to meet the City's infrastructure and capital requirements. Resource

availability and capital needs are assessed frequently and appropriate planning responses are taken. For example, there has been a greater need for construction and renovation of schools due to changes in enrollment, educational initiatives and accreditation needs, and this has been done with a focus on maximizing the reimbursement from the state's school building reimbursement program.

CBP evaluates and refines the relationship between the City's capital needs and resources as the City moves through each fiscal year. This process is documented by an annually updated five-year capital plan. Since FY99, the proposed capital plan has been integrated with the operating budget. The FY04-08 Capital Plan reflects the administration's commitment to comprehensive planning and investment by spotlighting projects ranging from future economic development projects to strategies for neighborhood revitalization.

In addition to its planning functions, CBP also plays an ongoing project oversight and supervisory role during the implementation phase of its capital projects. CBP reviews and approves all capital contracts and monitors project costs and schedules to ensure the adequacy of available funding sources.

Program-Based Budgeting and Assessments

Since FY88, the City of Boston has used a program-based budgeting system to track expenditures and service levels by major functions or programs. This budgeting system complies with the standards of the Government Finance Officers Association, which has consistently recognized the City's efforts with its Distinguished Budget Presentation Award.

The City has built on this base of budget and performance information to design a system of departmental accountability for service outcomes, making sure services are delivered at the level expected, with a focus on customer satisfaction and service efficiency. The Office of Budget Management (OBM) plays a central role in the collection and analysis of performance data, ensures proper documentation of results, and assists departments in pursuing opportunities for improvements. All financial commitments by departments are first reviewed by OBM for

conformance with service priorities and funding availability.

Debt Management

The Treasury Department manages all City borrowings. The Treasury Department has focused on the timing of borrowings to take advantage of favorable market conditions and has carefully managed the City's cash flows to help eliminate the need for short-term borrowings. The Treasury Department has established a series of debt management guidelines. The guidelines set forth the City's management policies toward rapidity of debt repayment, debt affordability, the limitation on the level of variable rate debt the City will employ, target savings for refundings, and reporting to the financial community and the rating agencies.

The City uses a comprehensive, interactive debt capacity model to assist City debt management administrators in evaluating the potential impact of debt issues on cash flow, credit and statutory debt capacity. Two mainstays of the City's positive debt service position have been the relative stability of the annual debt cost to remain below 7% of total general fund expenditures and adherence to rapid debt retirement ensuring that at least 40 percent of outstanding principal be retired in five years, and 70 percent in ten years.

Other factors have contributed to this favorable debt position in the recent past. The City took maximum advantage of low interest rates and issued four large refundings of the City's general obligation debt in April 2001, August 2002, November 2002 and February 2003. The City has managed its cash flow such that short-term revenue anticipation notes have not been needed. This has been possible mainly because of the switchover from semi-annual to quarterly billing for property tax and from semi-annual to quarterly distribution of state local aid. The overall success in the City's adherence to its debt management policies and the City's image in the capital markets have contributed to bond rating upgrades, and, most recently, in February 2003 the City was awarded ratings of Aa2, AA- and AA- (without regard to a bond insurance policy) from Moody's Investors Service, Standard and Poor's and Fitch IBCA, Inc., respectively. The City also utilizes lease-purchase financing of equipment with a two to seven year useful life. Annual lease-purchase

financing has totaled \$7 to \$10 million for vehicles, computers, and lighter equipment.

Pension Management

As required by law, the State-Boston Retirement System (SBRS), of which the City is the largest member, performs a full valuation at least once every three years. The system uses the valuation to determine the total system liability and the annual funding requirement. The SBRS hires an investment manager who oversees the various fund managers of the SBRS pension assets. The long-term investment performance of the SBRS has exceeded the long-term investment assumption of 8% upon which the funding schedule is partly based, recording a five-year (ending in 2001) average annualized return of 8.51% and an average annualized return from January 1, 1985 through December 31, 2001 of 10.78%. In 2001 the median rate of return for all Massachusetts' public pension funds was -3.90%, and the rate of return for the SBRS was -5.72%. Over the years, the City has worked with the SBRS to maintain a conservative and responsible pension funding schedule. This has included maintaining a conservative investment rate of return assumption and a funding schedule that fully funds the system several years earlier than the statute requires.

Risk Management

Across the City, risk management efforts are made to prevent, minimize, and finance unexpected losses to the City's human, financial and physical assets. The Office of Budget Management's Risk Management Program works to maximize the effectiveness of this intradepartmental effort by reviewing citywide risk costs, assisting risk management efforts, and implementing a citywide risk financing strategy.

Following is further discussion of certain types of losses and how they are managed:

- The total cost of employee health insurance exceeded \$145 million in FY02. The Office of Human Resources (OHR) manages healthcare costs through competitive bidding and annual negotiations of benefits with HMO healthcare plans and a self-insured indemnity plan. The average per-employee annual cost increase for the past ten years has been contained at 6% per year, with higher increases in recent years.

- The Office of Human Resources and the Police and Fire Departments manage citywide employee injury costs, which total over \$50 million per year. Specific efforts continue in the Fire department to contain injury costs, which represent 40% of the citywide total.
- The City's low liability claims costs total between \$3 million and \$7 million annually. Managed by the City's Law Department, legal claims are limited by MGL Chapter 258, which caps the City's liability for most claims.
- Unexpected losses to physical city property have been minimal, with the exception of the 1998 flood at the McKim Library, and are managed by individual operating departments.
- Because the City's risk financing program stresses departmental accountability, typical risk costs for injuries, legal claims and property losses are funded by individual departments. The City budget, in turn, is protected from a large loss through a risk retention reserve which will reach a \$6.5 million balance in 2003, and catastrophic property insurance coverage that limits property losses which exceed a \$20 million retention.

Property Tax Collections

The collection of property taxes has been improved by enhanced tracking systems and more thorough collection procedures and notifications. This has resulted in an increased rate of collection.

The City has implemented an aggressive enforcement program that continues to reduce the number of tax accounts that are delinquent, and to discourage new delinquencies. The City achieved a property tax collection rate of 98.6% of the FY02 gross levy as of June 30, 2002. The City's enforcement program includes the adoption of stricter guidelines for handling delinquent taxes, utilizing a variety of collection remedies authorized by state statute and working closely with the Commonwealth to refine the tax collection system. For example, the City, following requisite approval from the Massachusetts Department of Revenue, was the first municipality in the Commonwealth to amend tax bills to include past due amounts. The City has implemented an automated tax information hot line that allows taxpayers to call from 7 a.m. to 10 p.m., seven days a week, for updated tax balances,

duplicate tax bills or information on other tax related questions. In addition, during FY99, the City combined customer service for the valuation and collection aspects of property taxes that are traditionally administered separately by the City's Assessing and Treasury departments. These changes, coupled with letter writing campaigns to first-time delinquents, have resulted in a significant reduction in the number of past due accounts.

Expenditure Controls

In addition to the management systems described above, the City operates under several statutory financial control systems. Certain controls established in the 1982 Funding Loan Act and its 1986 amendments set limits on flexibility in financial administration. Under the 1982 Funding Loan Act, for example, until April 15 of each year, the Mayor is authorized to reallocate no more than \$3 million.

Several other financial controls were enacted by state law and implemented during the 1980s. An expenditure allotment system prevents departmental overspending of personnel appropriations. Additional state law provisions are directed at the control of School Department spending. These controls, teamed with conservative and cautious estimates of annual revenue, have aided the City in avoiding operating budget deficits every year since FY85, and have aided the School Department in avoiding operating budget deficits every year since FY90.

Reserve Fund

As required by law since 1986, the City has been maintaining a reserve fund equal to 2 1/2% of the preceding year's appropriations for all City and County departments except the School Department. The fund may be applied to extraordinary and unforeseen expenditures after June 1 in any fiscal year with the approval of the Mayor and the City Council. To date, this budgetary reserve has not been utilized. As of June 30, 2002, the reserve fund had a balance of \$21.0 million. The City more than fulfilled the FY03 Tregor Reserve requirement to add \$485,000 to the reserve before the close of FY02 by adding \$1 million. The City expects to fulfill the FY04 Tregor Reserve requirement to add approximately \$155,000 to the reserve before the close of FY03.

Accounting System

Financial management is supported through the City's PeopleSoft System. This computerized financial management and human resources system is designed to track standard accounting functions such as revenues, expenditures, accounts payable, accounts receivable and general ledger. In addition, the PeopleSoft system performs the specialized functions of encumbrance control, fund accounting and grants management, as well as other accounting and budgeting functions. The utilization of this system has improved the financial monitoring and the reporting of funds management. On-line access to financial information allows department managers to evaluate directly the financial performance of their departments and specific programs within their departments.

The Auditing Department has developed a fiscal year closing process that limits and controls departmental appropriation reserves through encumbrances and closely monitors the amount of prior year reserves carried forward, which maximizes the City's undesignated fund balance. In addition, the process allows for the year-end closing and accompanying financial statements to be completed in an efficient and timely manner. The Auditing Department monitors payment lag times and citywide vendor payments. Both the tracking and scheduling of vendor payments ensures timely payments to vendors and enhances cash management. Payments to major utilities such as Keyspan and Nstar are monitored by a system that addresses disputes efficiently, thereby ensuring application of credits and the elimination of late charges.

Management Letters

Each year, following the completion of the financial statements, the City's independent auditors deliver a management letter containing comments and recommendations on internal financial controls. The current management letter indicated no material weaknesses in the City's management. Specific management improvements have been recommended in the management letters, and many of the controls that the City has implemented originated from the auditors' recommendations. The auditors have commented favorably in successive management letters on the City's progress in addressing the

auditors' suggestions. Through its own efforts and, when required, through appropriate legislation, the City intends to continue to modify and improve its internal financial controls with the advice of its auditors.

Contracting Procedures

The Uniform Procurement Act, Massachusetts General Laws Chapter 30B, enacted by the Commonwealth in 1990 (the UPA), creates uniform procedures for the contracting of services and supplies by all municipalities in the Commonwealth. The Auditing Department, working with the City's Law Department, has developed and implemented internal processes to conform City contracting procedures to the requirements of the UPA and other statutes specifying required contract procedures.

